

Sixth Biennial Marine Transportation System Research and Technology Coordination Conference

“Ferries” (non-plenary Panel): Friday, November 16th 11:00AM

Government Aides to Ferry Building and Operation: U.S. Department of
Transportation Assistance

INTRODUCTION

Ferry usage in the United States was largely abandoned in the Post World War II period as the result of readily available auto transport, inexpensive fuel costs, and an extensive program of U.S. government-funded highway construction. Recent widespread problems with highway traffic congestion and the environmental and capital costs associated with new highway, bridge and tunnel infrastructure have caused the superiority this highway transportation mode to be questioned. Various federally funded regional and national ferry transportation studies are underway. Selected urban locations like New York and Boston have seen new ferry services successfully introduced after a 30 or more year hiatus. This is why we are meeting in this session today.

Two agencies within the U.S. Department of Transportation (“US DOT”), the Maritime Administration (“MARAD”) and the Federal Highway Administration (“FHWA”), administer programs which deserve our attention as providing assistance to both public and private sector parties engaged in the establishment and expansion of ferry transportation systems. The underlying legislative authorizations for the two programs administered by MARAD are contained in the Merchant Marine Act, 1936 (the “1936 Act”), as amended by the Merchant Marine Act of 1970 (the “1970 Act”), and the Federal Ship Financing Act of 1972 (the “1972 Act”). The authorizations for the FHWA programs are set out in the Transportation Efficiency Act for the 21st Century (“TEA ‘21”) which carries forward the program initiatives of the Intermodal Surface Transportation Efficiency Act of 1991 (“ISTEA”).

The MARAD programs can be fully accessed through dealings with US DOT acting alone, while those administered by FHWA will require dealings with US DOT and with relevant state departments of transportation, and regional and local transportation planning bodies.

DISCUSSION

1. Maritime Administration (“MARAD”). MARAD’s stated mission is “to promote the development and maintenance of an adequate, well-balanced, United States merchant marine, sufficient to carry the nation’s domestic waterborne commerce and a substantial portion of its

waterborne foreign commerce, and capable of serving as a naval and military auxiliary in time of war or national emergency." MARAD also seeks to ensure that the United States enjoys adequate shipbuilding and repair service, efficient ports, effective intermodal water and land transportation systems, and reserve shipping capacity in time of national emergency.

My presentation today deals principally with two programs administered by MARAD under the 1936 Act, as amended by the 1970 Act and 1972 Act, and their use in facilitating ferry vessel acquisitions. These MARAD programs provide private sector ferry operators with uniquely attractive means for financing new vessel construction. One of the programs provides access to long term fixed rate borrowing at low U.S. government guaranteed rates; the other the means for the accumulating income for vessel purchases on a before-tax basis. The programs are accessed through MARAD, with only that agency's involvement.

While the MARAD programs are customarily employed by private sector parties, they are available for both public and private sector use.

1.1 Title XI Financing Guarantees: Summary. Under the first, and more important, program, the U.S. Government guarantees full payment of principal and interest on bonds issued by a vessel owner. The Title XI Program allows ferry operators to acquire new vessels with a down payment of only 12.5 percent of the vessel cost, with the 87.5 percent balance of the purchase price financed over the 25 years following the vessel delivery. The Program is available for both construction period and post delivery financing. Title XI bonds sold today would carry a coupon rate in the 5.25 percent range. In contrast, current private sector financing would likely carry an 8 to 9 percent coupon rate, for a maximum of 80 percent of vessel cost, and be limited to 8 to 10 years after vessel delivery.

MARAD collects filing, investigation and guarantee fees in connection with the Title XI Program. The Title XI application and approval process, from the date the application is submitted through the date of bond sale and closing, will generally take a minimum of six months.

1.2 Title XI Financing Guarantees: History, Scope and Terms. In its original form, the Title XI program provided for federal vessel "mortgage insurance" to enable U.S. citizen vessel owners participating in the 1936 Act subsidy programs to obtain the long term financing necessary to accomplish their fleet expansion and renewal. The current text dates principally from the 1972 Act which changed the program terminology from "mortgage insurance" to that of "financing guarantees."

The Program provides participating vessel owners with financing guarantees for vessel related debt, for construction period and post delivery financing, of up to 87.5 percent of the vessel's "actual cost." Title XI interest rates are determined in private sector negotiations and will be slightly higher than the interest rates carried by comparable U.S. Treasury obligations. The maximum

guarantee period is the lesser of 25 years or the remaining economic life of the vessel. Amortization in equal payments of principal is usually required. However, MARAD will approve other amortization methods if sufficient security is offered.

Applications are made in accordance with a standard MARAD form. Projects which meet Program requirements are approved, and a MARAD "Letter Commitment" to guarantee the project obligations is issued. This is followed by the completion of the vessel owner's financing documents in accordance with the terms of the Letter Commitment, and their submission for MARAD review and approval. MARAD will generally approve the financing documents, and the transaction will be closed within six weeks after the submission of the documents.

A filing fee of \$5,000 is payable when the Application is filed. An investigation fee of $\frac{1}{2}$ one percent of the face value of the vessel owner's debt obligations, up to and including \$10 million, plus $\frac{1}{8}$ of one percent on all obligations to be issued in excess of \$10 million, is payable prior to issuance of the Letter Commitment. A guarantee fee which will be fixed by MARAD at between (i) $\frac{1}{4}$ of one percent to $\frac{1}{2}$ of one percent during vessel construction, and (ii) $\frac{1}{2}$ of one percent to 1 percent for the period after vessel delivery is payable at closing and may be financed as a part of vessel cost.

There are currently over \$3.7 billion in Title XI guarantees in force, covering approximately 600 vessels owned by over 80 shipowners.

1.3 Title VI Capital Construction Fund ("CCF") Tax Deferrals: Summary. Ferry vessel owners participating in the CCF Program can accumulate the monies necessary for the construction and reconstruction of their vessels on a "before-tax" basis. The Program is available for vessels which will be employed in the Alaska, Hawaii, Puerto Rico and Great Lakes trades, and in certain Gulf of Mexico and other offshore services. The Program allows a taxpayer (which enters into a contract with MARAD) to shelter income from current taxation (generally federal and state) in exchange for the taxpayer's commitment to purchase or construct a new ferry vessel or vessels at some future date. It may be useful to think of the Program as providing the taxpayer with the use of a form of "super" accelerated depreciation.

There are no MARAD fees associated with the CCF Program. The burden of interfacing with MARAD Program administrators is minimal, and the application and approval process, from the date the application is submitted through the finalization of the MARAD contract package can generally be accomplished in less than 45 days.

1.4 Capital Construction Fund ("CCF"): History, Scope and Terms. The CCF Program traces its history to the Revenue Act of 1920. Title VI of the 1936 Act authorized the creation of

"regular" and "special" reserve funds into which contracting U.S. citizen vessel operators engaged in "essential" foreign trades, deposited earnings, entirely free of tax, dedicated to the construction of vessels to be employed in these trades. In the aftermath of World War II, the Bureau of Internal Revenue forced a renegotiation of these contracts which limited the benefit to the deferral of taxes on this foreign trade income. The 1970 Act added Alaska, Hawaii and Puerto Rico, and the Great Lakes, as qualifying trades. More recently, certain Gulf of Mexico and other off-shore trades have been added as a result of MARAD Program interpretations.

The CCF Program is intended to enable U.S. citizen vessel owners to accumulate the capital necessary to accomplish fleet expansion and renewal on a before-tax basis. The Program achieves its goals by means of vessel owner contracts with MARAD, under which the owner commits to complete an approved vessel construction program, and MARAD commits to defer the tax on the measure of taxpayer income dedicated to finance this vessel construction. The shelter is temporary because the tax cost basis in the future vessel is reduced for the purpose of computing depreciation when that vessel is placed in service.

The CCF Program authorizes the deferral of federal income taxes on vessel income, and the gain on sales of vessels, deposited (and on any income on such deposits which is itself deposited) under the terms of the CCF contract. The tax deferral begins when a deposit is made to the fund. For example, if the deposit is attributed to vessel operating income, the taxpayer will reduce its vessel operating income for that taxable year by the amount of the deposit. The tax deferral ends when the money in a CCF is withdrawn in a "qualified" withdrawal to finance the contract-approved vessel renewal, or is withdrawn, or deemed withdrawn, in a "non-qualified" withdrawal.

When the CCF financed vessel is placed in service, the cost basis of the vessel will be reduced by the amount of its CCF financing, and the government will begin to recoup a part of the deferred tax due to reduced depreciation deductions. However, to the extent that the taxpayer's vessel construction program will accommodate additional deposits, the tax deferral may be continued indefinitely.

There are approximately 180 CCF Program contract holder agreements. Since the Program was expanded in 1970, fund holders have deposited more than \$7 billion in Program accounts and have withdrawn almost \$6 billion for the modernization and expansion of the U.S. merchant marine.

2. Federal Highway Administration ("FHWA"). The FHWA is charged with creating "the best transportation system in the world for the American people through pro-active leadership, innovation, and excellence in service." The FHWA is also responsible for providing "expertise, resources, and information to continually improve the quality of our nation's highway system and its intermodal connections."

2.1 Transportation Efficiency Act for the 21st Century ("TEA '21"). The Transportation Equity Act for the 21st Century ("TEA'21") authorized funding for the Federal surface transportation programs for highways, highway safety, and surface transit for the 6-year period 1998-2003. TEA '21 also directed US DOT to conduct a study of ferry transportation in the United States and its possessions. This study, the "National Ferry Data Base," was completed in December 2000. Copies of the National Ferry Database are being made available by FHWA this morning on computer discs. Detailed information concerning all aspects of TEA '21 can be accessed at:

"www.fhwa.dot.gov/tea21/suminfra.htm".

While the MARAD programs are administered directly by MARAD acting alone, the FHWA programs under TEA '21 are administered by US DOT in collaboration with state departments of transportation and regional and local planning authorities.

Two programs deserve our attention today, one which involves monies which have been specifically set aside for use in the construction of ferry vessels and terminal facilities, and one which involves monies which are generally available based upon location needs for air quality improvement or maintenance.

2.2 Ferry Boat Discretionary Fund ("FBD"). TEA '21 authorized a total of \$220 million for construction of publicly owned ferry boats and ferry terminal facilities. From a ferry project sponsor's viewpoint, these so-called FBD monies would appear to be the obvious first stop in TEA '21. And indeed one might fairly say that this "was" the case. Because interested Congressional personnel saw to it that substantial portions of this money was set aside and ear-marked to specific projects within their jurisdictions. (I refer to one of the projects which was so benefitted in my discussion of public private partnerships.) As a result of these set asides, very little if any of these FBD monies will in fact be available for other projects during the TEA '21 authorization period.

2.3 Congestion Mitigation and Air Quality Improvement ("CMAQ"). The Congestion Mitigation and Air Quality Improvement, "CMAQ," program which had been such an important part of the Intermodal Surface Transportation Efficiency Act of 1991 ("ISTEA"), was continued at a total authorized level of \$8.1 billion for the six years of TEA '21. These CMAQ funds are available through state and local governments to assist these jurisdictions in meeting the requirements of the Clean Air Act. Many, if not most, of the substantial passenger ferry projects being studied and implemented across the nation today are in areas which do not meet the National Ambient Air Quality Standards (non-attainment areas), or in former non-attainment areas (maintenance areas).

These CMAQ funds, distributed to States based upon a formula which considers a location's population by county and the severity of its air quality problems within the non-attainment and maintenance areas, are available for purchase of publicly owner terminal sites, for the construction

or improvement of terminals, and for the purchase of vessels. Under certain circumstances, they may be made available to assist in the start-up funding for privately owned ferry vessel operations.

It is this CMAQ funding, rather than the FBD, which will deserve the principal attention of both public and private sector ferry project sponsors.

3. "Public Private Partnership" Modes.

There has been a great deal of talk about so-called "public-private partnerships" as a means of establishing ferry transportation systems or of facilitating the expansion of existing systems.

As with the subject matter of business partnerships more generally, these "partnership" arrangements may take many forms. One useful paradigm, and one which has been proven in operation, involves the commitment of the public sector to provide the "bricks and mortar" of terminal facilities (using ISTEA and TEA '21 programs), with the private sector parties providing the ferry vessels themselves (using the Title XI program). Perhaps the best example of such a partnership in operation is that of New York City's principal ferry service provider, Port Imperial Ferry Corp. ("PIFCO").

PIFCO, which conducts its ferry business as "NY WATERWAY," employs a 23 vessel fleet of passenger ferries which operate within and to and from Manhattan, from other New York City boroughs, and from multiple Hudson, Bergen and Monmouth County, New Jersey locations. NY WATERWAY was started a dozen years ago as a modest service to provide access for Manhattan residents to a golf driving range on Weehawken, New Jersey property which PIFCO had acquired as a real estate speculation. NY WATERWAY now provides some 30,000 passengers with non-subsidized daily transportation services between the multiple slip and terminal locations which it serves.

NY WATERWAY commenced its service with an initial reliance on a midtown Manhattan location which it owned, and a out-of-service passenger ferry hull which it converted to terminal use at the Weehawken property. NY WATERWAY expanded its service making use of publicly owned Manhattan and New Jersey slips. PIFCO then sought and received FHWA and New Jersey Department of Transportation ("NJ DOT") collaboration under ISTEA section 1064 in providing the funding for the studies necessary for the planning of a new state-of-the-art terminal facility at the Weehawken property.

Moving from planning to execution, PIFCO then obtained Congressional and New Jersey and local approvals for a TEA '21 set aside of FBD monies to entirely fund the construction of this new terminal, which will be located on a portion of the Weehawken property, which (in order to

comply with the public ownership requirements) PIFCO will donate to NJ DOT. Upon completion, the terminal will be managed by a PIFCO affiliate under a long term contract with NJ DOT.

NY WATERWAY's initial vessel purchases were financed with bank borrowings with terms of no more than eight years. In 1996, NY WATERWAY accomplished its first MARAD Title XI financing with the sale of 25 year bonds. The company used the proceeds obtained from the sale to repay its term bank borrowings, and to finance one new vessel then under construction. Since that time, NY WATERWAY has financed all of its new construction with 25 year bonds making use of MARAD Title XI Program guarantees.

With PIFCO's business affairs so arranged, NY WATERWAY has been able to maintain and expand its ferry transportation services on a profitable basis without the receipt of any operating subsidy. This arrangement has had the benefit of freeing New York City from the necessity of subsidizing these services. And, it has allowed NY WATERWAY to operate its business without interference from New York City, and without the intrusive financial oversight which will almost always accompany the operations of a government subsidy recipient.

PIFCO's employment of these and FHWA and MARAD programs in combination provides a useful case study in what can be accomplished. PIFCO personnel developed a business plan, and then initiated contacts with NJ DOT and US DOT personnel and with Congressional members and staff, to educate these parties concerning PIFCO's operations and objectives. The company then worked with NJ DOT and US DOT and Congressional staff to perfect the ISTEA and TEA '21 grant packages for the terminal facilities necessary to a successful and expanding operation. PIFCO worked with MARAD personnel to explain NY WATERWAY's business and gain MARAD Title XI Program financing guarantees which allowed NY WATERWAY to move from 8 year to 25 year vessel asset financing and so to match vessel payment schedules with vessel useful lives.

Similar public-private partnerships are in planning stages at other U.S. locations.

4. The Future: Opportunities and Challenges.

Ferry services provide significant contributions to regional and local transportation networks across the entire country. New York commuter ferries are providing attractive alternatives to congested and unpredictable bridge and tunnel routes. The Washington State Ferry System, the largest volume passenger and vehicle system in the nation, meets essential transportation needs and provides complementary services which have themselves become a major tourist attraction. The Portland-Casco Bay system provides island lifeline services, which are used by commuters year round and seasonally by vacationers. New Orleans and Mississippi River services serve as

supplemental bridges connecting residents with cross river employment. But, it is San Francisco's system which has continued to set the most interesting contemporary precedents.

Ferries have been in operation on San Francisco Bay for over 150 years, with over 30 major ferry routes in service at one time or another. Commuter ferry services were never entirely discontinued in the Post World War II period. The past three decades have seen the expanding re-institution of various cross Bay services to provide commuting alternatives to the bridges and the Bay Area Rapid Transit ("BART") system. San Francisco initiated the first U.S. purpose built high speed ferry transit and provides the prime example of water transit routes planned as deliberate alternatives to landside transportation options. And, as one examines the national ferry transportation scene, one should not be surprised that the Bay Area's plans for the future are among the nation's most ambitious.

A San Francisco Bay Area Water Transportation Authority has been established to plan and manage the expansion of high speed ferry service for the Bay Area. Phase I, a five to ten year program linking 28 terminals via 20 basic routes, will require a fleet of 70 ferries which will carry 15 to 20 million passengers annually. A Phase II will encompass as many as 40 terminals, up to 30 routes and as many as 120 passenger-only ferries, and will carry some 25 to 30 million passengers on an annual basis.

These San Francisco Bay Area plans appear to contemplate a blended public-private system with US DOT funding for ferry terminals, ferry vessels and a supporting bus fleet, in combination with a continuation and expansion of the privately owned ferry services which have played such an important role historically. Given the magnitude of the Bay Area undertaking, the use of private sector investment and MARAD Title XI guarantees would appear to offer obvious advantages. It will be interesting to observe, as the development of this Bay Area system moves forward, just what forms of public-private sector partnerships will be developed.

New ventures are underway for Alaska, for the Seattle region, and for various Coastal and U.S. Great Lakes routes. Today, U.S. shipyards are proven builders of stable catamaran platforms with vessel speeds which range between 35 and 50 knots, and sizes appropriate to the services in which the vessels are to be employed. New, low wake designs are being proven effective. These and other developments open new opportunities for ferry transportation. From every standpoint, from out-of-pocket costs to the taxpayer, to protection of the environment, the logic favoring the addition of water transportation resources is compelling. But, the major question which remains is "How are these water transportation projects to be funded?"

Looking beyond TEA '21, federal sponsored funding for water transportation should be substantially enhanced. But, to date, the maritime sector has been a "poor second cousin" to highway and air service interests. In the near term, state and municipal bond funding for project

financing will be aided by lower interest costs. But declining general tax revenue collections will likely cloud this state picture. MARAD Title XI Program financing offers obvious cost and cash flow benefits for new construction and fleet expansion. However, with the one exception which I have discussed above, these benefits have been almost completely ignored by public sector planning authorities.

CONCLUDING THOUGHTS

How will the solutions to our ferry transportation needs developed? How will they be financed? Should these solutions be publicly funded in their entirety or should they involve some measure of private sector participation? If public-private partnerships are a desirable means, how are the roles of the public and private sectors best defined and enhanced?

Thirty years ago this month, in November 1971, I had taken leave from my law partnership in Philadelphia to assume a new job as General Counsel of MARAD. There, I was charged with turning the Merchant Marine Act of 1970 Act into a working program, and, once this was done, with the drafting of the Federal Ship Financing Act of 1972.

The 1970 Act had been passed in the U.S. Congress with only two dissenting votes (one in the House and one in the Senate). It had authorized various construction and operating subsidy grants as the basis for the "revitalization" of our U.S. flag merchant marine. However, under the Act the majority of the capital necessary for this ambitious "revitalization" was to be raised in the private sector. This was to be accomplished with earnings accumulated by private sector vessel operators (under Title VI "capital construction fund" contracts), and with these operators' borrowings from private sector lenders (made possible by Title XI "financing guarantees").

Over the course of the past 30 years most of my professional time has been devoted to assisting U.S. vessel owners with their 1970 Act projects. Today, it is only these Title VI and Title XI Programs of the 1970 Act which remain. Earlier this year, the Administration's Office of Management and Budget proposed the termination of the Title XI program, and the transfer of administration of the Title VI program to the Treasury Department. Arizona's Senator John McCain has joined in this effort, publicly seeking the termination of the Title XI program as "corporate welfare." However, neither Program involves federal grants in aid. Both rely upon private sector investment, and upon principles of public-private partnership.

It will be interesting to observe what role, if any, these Programs, and the private sector investment which they foster, will be destined to play in the expansion of U.S. ferry transportation during the 21st Century.

Thank you.

Sixth Biennial Marine Transportation System Research and Technology Coordination Conference

“FERRIES”

(non-plenary Panel): Friday, November 16th, 11:00AM

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H. Clayton Cook, Jr. “The Role of Government in Financing Ferry Boats
and Operations (Government Aides to Ferry Building and Operation)”

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H. Clayton Cook, Jr. graduated from Princeton University with a degree in Chemical Engineering, and received his LL.B. degree from The University of Virginia. He served as General Counsel of the Maritime Administration in the Nixon and Ford Administrations, where he was charged with the implementation of the Merchant Marine Act of 1970 and the drafting of the Federal Ship Financing Act of 1972. He was a member of the Reagan Administration Citizens Advisory Panel on U.S. Maritime Trade and Technology, and a member of the Military Sealift Command National Defense Executive Reserve in the Reagan and Bush Administrations.

Mr. Cook is currently Counsel to the Washington, D.C. law firm, Bastianelli, Brown & Kelley, Chartered, and a partner in the New York consulting firm, Management & Transportation Associates, Inc., where he assists clients in structuring and implementing transactions involving the construction and financing of U.S. flag vessels, and the availability of U.S. government financing guarantee, tax deferral and other promotional programs. Mr. Cook has been a senior planning or supervising attorney in vessel financing transactions totaling more than \$3 billion. Recent engagements have included vessel owners involved in existing and start-up ferry operations and U.S. shipyards involved in the construction of ferries and “fast ferries,” where Mr. Cook has assisted these clients in accessing the ferry assistance programs administered by U.S. Department of Transportation agencies.

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Government Aides to Ferry Building and Operation:
U.S. Department of Transportation Assistance

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